

STATE CONTROLLER'S OFFICE  
PERSONNEL/PAYROLL SERVICES DIVISION  
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DATE: January 18, 2002

PAYROLL LETTER # 02-004  
CIVIL SERVICE ONLY

TO: All Agencies in the Uniform State Payroll System

FROM: RALPH ZENTNER, Acting Chief  
Personnel/Payroll Services Division

RE: **FRINGE BENEFIT/EMPLOYEE BUSINESS EXPENSE REPORTING COMPLIANCE PROJECT**

This Payroll Letter provides information regarding the 2001 Fringe Benefit/Employee Business Expense (FB/EBE) Compliance Project.

#### FB/EBE COMPLIANCE REQUIREMENTS

Employers (departments) must satisfy three tax requirements:

- 1) Report all taxable FB/EBEs provided employees as outlined in the Payroll Procedures Manual (PPM) Section 120-175;
- 2) Report all FB/EBEs based on "constructive receipt" --FB/EBEs must be reported when the employee is paid and/or receives the "value/benefit"; and
- 3) Report all taxable FB/EBE data accurately.

NOTE: The PPM can be accessed at: <http://www.sco.ca.gov/ppsd/empinfo/links.htm>

#### OVERVIEW

Two Thousand One (2001) marked the final year of a six year project to voluntarily secure and maintain employer compliance with federal and state employment tax requirements.

On behalf of the State, this office sought to achieve four primary objectives. These objectives were: identify taxable and reportable benefits provided State employees and implement appropriate tax withholding and reporting processes; contact and educate each systemwide and local employer regarding their respective FB/EBE roles and responsibilities; identify State compliance levels; and assist systemwide and local employers to correct program oversights.

These objectives were achieved from 1996 through 2001 via various initiatives. The primary initiatives were the annual FB/EBE Compliance Certification Project and providing direct technical support to employers. The Compliance Certification Project insured annually that all (340) employers were aware of mandated FB/EBE requirements, were provided their respective reporting patterns and requested to either certify full compliance or request technical assistance from this office. Since 1996, the number of employers certifying full compliance rose from 193 to 340 employers.

Since 1996, employers placed an average 600 phone calls for technical assistance per year. Annually, this office conducted an average of 20 departmental onsite which addressed technical FB/EBE departmental needs. Technical assistance was routinely provided to systemwide employers (e.g. Department of Personnel Administration) in reviewing benefit programs for taxability, identifying program tax oversights and information sharing regarding statewide FB/EBE compliance. This assistance also included implementation of new FB/EBE tax withholding and reporting processes. Via these and other efforts, all employers could achieve and maintain tax compliance.

Ultimately, employer performance will affect tax authority examinations, audits and any resulting financial liabilities. The 2001 project results continued the previous five year pattern of increased voluntary FB/EBE tax compliance. Employer performances from 1996 through 2001 underscore this success:

- 46% increase in taxable FB/EBE wages reported
- 42% increase in number of departments reporting FB/EBEs
- 33% decrease in "surge" (late) reporting
- 5% document error ratio -- down from 11%

Although these advances are impressive, noncompliance issues regarding comprehensive and timely reporting continue. Since 1998, all departments not reporting, reporting fewer benefits than the previous year or reporting infrequently were contacted. In 2001, 70 departments were called and subsequently, 39 (55%) began reporting, reported more benefits or started reporting per "constructive receipt".

Other compliance issues entail late reporting. Although surge reporting has decreased, over 15% of all reporting entities did not initially report until after the 1<sup>st</sup> quarter; 4.7% did not report until the 4th quarter. Relocation expenses, personal use of state vehicles and travel based benefits (meals less than 24 hours, commute mileage, etc.) were associated with most surge reporting at year end.

## 2001 IMPROVEMENTS

The following highlights 2001 improvements:

- The number of departments reporting FB/EBEs rose to 280 out of 340
- Taxable FB/EBE wages reported increased 6%; reported amounts exceeded \$40 million.
- 79% of departments now initially report FB/EBEs in the 1<sup>st</sup> calendar quarter, a 5% improvement over the 2000 level
- Twenty two departments reported FB/EBEs for the first time.
- Seventeen departments converted paper reporting to PIP for payments reportable by PIP.
- Taxable wage amounts reported via PIP rose 16%; over \$20 million was reported via PIP.

## FEDERAL DEVELOPMENTS

At the request of the Internal Revenue Service (IRS) this office met with IRS representatives from the Fed/State/Local Government Section-Pacific Group. This meeting was designed to clarify IRS roles and responsibilities, contact protocols, and federal timetables for their outreach compliance/examination activities.

The Pacific Group is now the State's central liaison and contact point regarding 50 tax based topics. These topics include: employment tax issues, FB/EBEs, resident/non-resident aliens, filing and reporting, examinations, worker classifications, etc. The Pacific Group's training and outreach efforts regarding travel and non travel benefits commenced June 2001 and regional examinations are projected to begin within 2002-2004.

## BUREAU OF STATE AUDITS (BSA)

BSA audits conducted 1999 through 2001 underscore the State's need for ongoing FB/EBE program audits. The audits revealed unique departmental problems and program oversights. The audits cited recurring employer issues including: belief that tax regulations do not apply to departments; inadequate internal training; and absence of departmental controls. 2002 AND THEREAFTER COMPLIANCE ACTIVITIES

Primary FB/EBE compliance continues to reside with systemwide and departmental employers performing their respective tax roles and responsibilities. By completing the Compliance Certification Project, this office's compliance role reverts to its primary withholding and reporting agent functions: tax payment, informational reporting, client education and oversight activities.

We will however continue to apprise employers of FB/EBE developments including reporting patterns, compliance issues and provide technical assistance as requested.

Questions regarding this payroll letter may be directed to Chris Knutson at (916) 322-8112 or e-mail (cknutson@sco.ca.gov).

RZ:ck